DEFENDANTS' EXHIBIT 318

https://www.wsj.com/articles/lenders-to-ailing-companies-circle-wagons-to-fend-off-distressed-debt-investors-11593169200

MARKETS

Lenders to Ailing Companies Circle Wagons to Fend Off Distressed-Debt Investors

Eaton Vance's courtroom victory in its battle for Serta shows that once-timid loan funds are now getting aggressive

By Matt Wirz Follow

Updated June 26, 2020 11:13 am ET

Eaton Vance Corp. mutual-fund manager Craig Russ isn't an activist, but when he heard that distressed-debt investors were going after Serta Simmons Bedding LLC, endangering his $200 million investment in the ailing company, he went to the mattresses.

Mutual funds have long shied away from fights with savvy hedge funds and other investors who specialize in troubled companies. But Mr. Russ and other fund managers got into a dogfight with the investors, including Apollo Global Management and Angelo Gordon & Co., and won in New York State Supreme Court last week. It is the latest example of how large money managers are upending the balance of power on Wall Street. Mr. Russ was joined by Invesco Ltd. and Credit Suisse Asset Management, among others.

These investment firms have supplanted banks over the past decade as the main lenders to corporations with junk credit ratings by purchasing these companies' "leveraged loans." The firms own more than 70% of the $1.2 trillion leveraged-loan market through funds known as collateralized loan obligations, or CLOs; mutual funds; and accounts managed for institutional clients.

Exhibit
Sveen 0019

The financial pain wrought by the coronavirus pandemic is forcing loans funds to change tack. Once viewed as slow and passive, the funds are banding together to fend off investors who seek to capitalize on financial crises by buying the debt of distressed companies and using it to take ownership of their businesses.

"The game has shifted," said Stephen Ketchum, founder of Sound Point Capital Management LP, which primarily manages CLOs and holds about $18 billion of loan investments. "CLOs and mutual funds are bigger collectively and individually than they were in the last crisis in 2009, and they are more sophisticated."

Historically, loan-fund managers sold out of companies at the whiff of default, but now many investments are too large to exit quickly. Boston-based Eaton Vance runs about $30 billion of leveraged-loan investments for its clients, and Swiss bank Credit Suisse's investing arm manages about the same amount in its CLOs.

"Managers who would otherwise be more conservative realize this is the new world they're living in, and they are being more aggressive," said Robert Gayda, a partner in Seward & Kissel LLP's bankruptcy practice.

Loan funds have spent recent months identifying companies they lend to that might default, forming committees and sometimes hiring lawyers and financial advisers in preparation for potential conflicts, according to portfolio managers, lawyers and analysts. In some cases, funds are also committing hundreds of millions of dollars in new loans, a tool more commonly employed by hedge funds.

Sound Point, for example, is teaming up with other CLO managers including CBAM Partners to protect investments in a roughly $1 billion loan made to Cirque du Soleil, which shut down performances in March and is restructuring its debt. The funds are battling private-equity giant TPG for control of Cirque du Soleil by offering to convert some of their loans into stock and to lend an additional $300 million to tide the company through the widespread shutdowns prompted by the pandemic, people familiar with the matter said.

Regulators and credit-rating firms have warned for years that record purchases of leveraged loans by investors were allowing risky companies to borrow excessively, setting lenders up for higher-than-average losses in the next economic crisis. The yield-hungry loan funds also allowed private-equity firms that own many of the companies to do away with key lender protections, exposing themselves to further dangers.

Loan investors' biggest fear—that private-equity firms would use a controversial tactic of moving assets such as intellectual property out of lenders' reach—became a reality this spring. Owners of companies including Serta, Cirque du Soleil and cosmetics maker Revlon Inc. used or contemplated using the technique to protect their stakes at the expense of loan holders, sometimes enlisting financial support from other private-equity and hedge funds such as Apollo, Angelo Gordon and Ares Management Corp.

Advertisements for Cirque du Soleil in Las Vegas in mid-March, just before the company said it was suspending its shows world-wide because of Covid-19. PHOTO: ETHAN MILLER/GETTY IMAGES

Serta had been struggling for several years, and after the U.S. economy shut down in March, loan funds that owned its debt asked private-equity owner Advent International what it intended to do, people involved in the matter said. Advent was negotiating via Serta's financial advisor Evercore Group LLC to borrow enough money from others including Angelo Gordon and Apollo to keep the company running. Advent offered to pledge about $1 billion of the mattress maker's intellectual property to the distressed-debt funds, but it told the loan funds nothing of the deal, the people said.

Borrowing from distressed-debt funds might have allowed Advent to protect its stake in Serta, but the distressed-debt funds would be first in line to collect on the intellectual property, ahead of the loan funds, if Serta had to file for bankruptcy.

"They were threatening to absolutely screw us," Eaton Vance's Mr. Russ said.

The loan funds learned of the plan in May, when Advent was already close to a deal with the distressed-debt investors, who had also bought about $600 million of Serta's existing loans at deep discounts. The loan funds quickly counteroffered with a new $200 million loan and a deal to swap about $1.3 billion of Serta's existing loans they owned into $875 million of new loans that would rank ahead of the debt the distressed-debt funds had purchased.

"Evercore ran a process on behalf of Serta and Advent in which Angelo Gordon, Apollo and Gamut Capital were among many parties specifically asked to structure an IP transaction," a spokeswoman for Apollo said. "Our group's proposal fully complied with the credit agreement and recent precedents and was less aggressive than Evercore's own proposed term sheet. Serta chose a far more aggressive transaction that we believe is contrary to the law and the loan agreements and as analysts noted, effectively strips non-participating lenders of nearly all their collateral."

Advent and Serta took the loan funds' offer because it provided a greater reduction in debt, people familiar with the matter said. Apollo and Angelo Gordon lost a lawsuit in New York State Supreme Court to block the transaction.

Mr. Russ said he hopes loan investors will start demanding stronger protections again. Until that happens, "this is the new reality," he said. "There's a whole new playbook, and it's all about maximizing recoveries."

—Vipal Monga contributed to this article.

Write to Matt Wirz at matthieu.wirz@wsj.com

Appeared in the June 27, 2020, print edition.